

STATE OF NEW YORK

DIVISION OF TAX APPEALS

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In the Matter of the Petition :  
of :  
**GOT-A-LOT-A-DOUGH, INC.** :  
for Revision of a Determination or for Refund of :  
Sales and Use Taxes under Articles 28 and 29 of the :  
Tax Law for the Period March 1, 1998 through :  
February 28, 2001.

DETERMINATION  
DTA NOS. 820112  
AND 820113

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In the Matter of the Petition :  
of :  
**CATHERINE KUNCMAN** :  
for Revision of a Determination or for Refund of :  
Sales and Use Taxes under Articles 28 and 29 of the :  
Tax Law for the Period March 1, 2000 through :  
February 28, 2001.

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Petitioner Got-A-Lot-A-Dough, Inc., 4261 Austin Boulevard, Island Park, New York 11558, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 1998 through February 28, 2001.

Petitioner Catherine Kuncman, 1147 East Broadway, Hewlett, New York 11557, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period March 1, 2000 through February 28, 2001.

A hearing was held before Timothy J. Alston, Administrative Law Judge, at the offices of the Division of Tax Appeals, Riverfront Professional Tower, 500 Federal Street, Troy, New York, on July 11, 2005 at 10:30 A.M., with all briefs to be submitted by September 22, 2005,

which date commenced the six-month period for the issuance of this determination. Petitioners appeared by Dennis H. Stamm, CPA. The Division of Taxation appeared by Christopher C. O'Brien, Esq. (Robert A. Maslyn, Esq., of counsel).

### ***ISSUE***

Whether the audit method employed by the Division of Taxation was reasonable or whether petitioners have shown error in either the audit method or result.

### ***FINDINGS OF FACT***

1. Petitioner Got-A-Lot-A-Dough, Inc. ("the corporation") owned and operated two Dunkin' Donuts stores in Nassau County, New York, located at 4261 Austin Boulevard, Island Park, New York and 3151 Lawson Boulevard, Oceanside, New York.

2. The Austin Boulevard store was open 24 hours a day, 7 days a week and was in operation throughout the entire audit period. The Lawson Boulevard store was open from 6:00 A.M. to 9:00 P.M. daily. The corporation commenced operation of the Lawson Boulevard store in May 1999. The stores sold mostly coffee, doughnuts, bagels, muffins and sandwiches. The stores also sold juice, soft drinks and milk.

3. On June 9, 2000, the Division of Taxation ("Division") sent a letter to the corporation scheduling an appointment for June 26, 2000 on which to commence a sales and use tax field audit of the corporation's business for the period March 1, 1998 through February 28, 2000. The Division's letter requested that all of the corporation's books and records pertaining to the stores for the audit period be available for review. Among the records specifically requested were the general ledger, cash receipts journal, Federal income tax returns, purchase invoices, sales invoices, guest checks, cash register tapes, bank statements, financial statements and exemption documents. The Division sent a second such appointment letter on July 20, 2000.

4. In response to the Division's request, the corporation produced income tax returns, sales tax returns, a 1999 general ledger, and about two months of 2000 daily sales summaries. The corporation produced no cash register tapes, sales invoices or other source records in response to the Division's request.

5. The Division deemed the records produced by the corporation in response to its request to be inadequate for the purpose of verifying taxable sales, and therefore, by letters dated November 20, 2000 and November 30, 2000 advised the corporation that an observation test of the corporation's sales would be conducted.

6. The Division conducted observation tests at the Austin Boulevard store on Monday, January 8, 2001 and at the Lawson Boulevard store on Thursday, January 11, 2001. Both tests were conducted from 6:00 A.M. to 6:00 P.M. and both were conducted by Division investigators and auditors. In conducting the tests, Division personnel recorded taxable sales on tally sheets. Nontaxable sales were not recorded. The tally sheets were then reviewed to confirm that the observed sales were taxable.

7. Total observed taxable sales at the Austin Boulevard store were \$684.69 for the 12-hour observation period. Taxable sales for the remaining hours of operation were estimated at 20 percent of taxable sales for the observation period or \$136.94. Total taxable sales for one day at Austin Boulevard, deemed a normal or regular day, were thus estimated to be \$821.36.

8. Total observed taxable sales at Lawson Boulevard were \$690.01 for the 12-hour period. The Division estimated taxable sales for the balance of the store's hours of operation to be one-sixth of taxable sales for the observation period, or \$115.00. Total taxable sales for a regular day at Lawson Boulevard were thus estimated to be \$805.01.

9. The Division then calculated the number of days in the audit period<sup>1</sup> for each store: 1,095 days for Austin Boulevard and 669 days for Lawson Boulevard. The Division determined that both stores had reduced sales on weekends, holidays and bad weather days. For Austin Boulevard, the Division calculated 156 weekend days, 30 bad weather days, and 24 holidays for a total of 210 reduced sales days. For Lawson Boulevard, the Division allowed 88 weekend days, 20 bad weather days, and 24 holidays for a total of 132 reduced sales days. After subtracting reduced sales days from total days, the Division determined 885 regular sales days for Austin Boulevard and 537 regular sales days for Lawson Boulevard.

10. The Division estimated daily sales on reduced sales days at Austin Boulevard at one-third of regular sales days or \$273.88. Reduced sales days at Lawson Boulevard were determined to be a quarter of regular sales or \$201.25.

11. The Division determined total taxable sales for the audit period at each location by multiplying regular day sales by the number of regular days in the audit period and adding to that total the product of reduced day sales multiplied by the number of reduced sales days. Such calculations yielded total taxable sales for the audit period of \$784,654.74 at Austin Boulevard and \$458,856.65 at Lawson Boulevard.

12. Total taxable sales by the corporation of \$1,243,511.39 were then reduced by sales tax included of \$97,417.94 and reported taxable sales for the audit period of \$548,795.00 to reach additional taxable sales of \$597,298.45. The Division apportioned such additional taxable sales to the sales tax quarters comprising the audit period by applying an error rate of 108.8382 percent to reported taxable sales in each quarter. This error rate equals the ratio of additional

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<sup>1</sup> The Division expanded the audit period to February 28, 2001. Thus the audit period for Austin Boulevard was 3 years and for Lawson Boulevard 22 months. The Division advised the corporation by letters dated April 6, 2001 and December 6, 2001 of the expanded period. The December 6 letter requested records to substantiate sales for the expanded period. The corporation produced no additional records in response to this request.

taxable sales as determined on audit to reported taxable sales. The Division then applied the prevailing tax rate to determine additional tax due per quarter. The Division thus determined \$50,770.36 in additional tax due for the entire audit period.

13. On May 15, 2003, the Division issued to the corporation a Notice of Determination which asserted \$50,770.36 in additional sales tax due, plus interest, for the period March 1, 1998 through February 28, 2001.

14. On June 6, 2003 the Division issued to petitioner Catherine Kuncman a Notice of Determination which asserted \$16,798.59, plus interest, for the period March 1, 2000 through February 28, 2001. The notice advised this petitioner that the Division had determined that she was a corporate officer or a person responsible for the collection and payment of sales and use taxes due from the corporation and therefore personally liable for the sales and use taxes due from the corporation.

15. Petitioner Catherine Kuncman was an officer of the corporation during the relevant period. She does not contest her status as a corporate officer or person responsible for the collection and payment of sales and use taxes due from the corporation.

16. As noted previously, the observation tests recorded taxable sales only. Any nontaxable sales observed were not recorded. The Division's audit method and results did not rely in any way on a separate calculation of the corporation's nontaxable or gross sales.

17. The Division did not audit or compute gross sales on a quarterly basis. The audit did estimate total gross sales for the audit period using the corporation's reported gross receipts per its Federal income tax returns for 1998 and 1999. The 1999 reported gross receipts were used to estimate gross sales for 2000 and January and February 2001. The audit report indicates total

audited gross sales for the audit period of \$2,728,792.00. The Division's auditor testified at hearing that the estimate of audited gross sales was done "for statistical purposes."

18. The corporation reported a total of \$1,742,038.00 in gross sales on its sales tax returns for the audit period. This total includes reported gross sales for eight of the twelve sales tax quarters in the audit period. The corporation did not report any gross sales on its returns filed for four of the quarters in the audit period.

19. For certain quarters of the audit period audited taxable sales exceeded reported gross sales. Specifically, for the quarter ending May 31, 1998 the Division determined audited taxable sales of \$29,377.27 while the corporation reported \$25,868.00 in gross sales for the same period. For the quarter ending August 31, 1998, the Division determined \$225,787.48 while the corporation reported \$221,893.00 in gross sales for the same period. For the quarters ending November 30, 1998, February 28, 1999, August 31, 1999, November 30, 1999, August 31, 2000, and November 30, 2000 audited taxable sales range from 85 percent of reported gross sales to 15 percent of reported gross sales.

### ***CONCLUSIONS OF LAW***

A. The standard for reviewing a sales tax audit where external indices were employed was set forth in ***Matter of AGDN, Inc.*** (Tax Appeals Tribunal, February 6, 1997), as follows:

a vendor . . . is required to maintain complete, adequate and accurate books and records regarding its sales tax liability and, upon request, to make the same available for audit by the Division (*see*, Tax Law §§ 1138[a]; 1135; 1142[5]; *see, e.g., Matter of Mera Delicatessen*, Tax Appeals Tribunal, November 2, 1989). Specifically, such records required to be maintained 'shall include a true copy of each sales slip, invoice, receipt, statement or memorandum' (Tax Law § 1135). It is equally well established that where insufficient records are kept and it is not possible to conduct a complete audit, 'the amount of tax due shall be determined by the commissioner of taxation and finance from such information as may be available. If necessary, the tax may be estimated on the basis of external indices . . . ' (Tax Law § 1138[a]; *see, Matter of Chartair, Inc. v.*

*State Tax Commn.*, 65 AD2d 44, 411 NYS2d 41, 43). When estimating sales tax due, the Division need only adopt an audit method reasonably calculated to determine the amount of tax due (*Matter of Grant Co. v. Joseph*, 2 NY2d 196, 159 NYS2d 150, *cert denied* 355 US 869); exactness is not required (*Matter of Meyer v. State Tax Commn.*, 61 AD2d 223, 402 NYS2d 74, *lv denied* 44 NY2d 645, 406 NYS2d 1025; *Matter of Markowitz v. State Tax Commn.*, 54 AD2d 1023, 388 NYS2d 176, *affd* 44 NY2d 684, 405 NYS2d 454). The burden is then on the taxpayer to demonstrate, by clear and convincing evidence, that the audit method employed or the tax assessed was unreasonable (*Matter of Meskouris Bros. v. Chu*, 139 AD2d 813, 526 NYS2d 679; *Matter of Surface Line Operators Fraternal Org. v. Tully*, 85 AD2d 858, 446 NYS2d 451).

B. In this case, the record clearly establishes the Division's clear and unequivocal

written requests for books and records of the corporation's sales, and the corporation's failure to keep or produce such records for the Division's review. The Division reasonably concluded that the corporation did not maintain books and records that were sufficient to verify its taxable sales for the audit period. Having established the insufficiency of the corporation's books and records, the Division properly resorted to external indices in the form of one-day observation tests at each store location to determine the corporation's taxable sales. Petitioners do not dispute either the absence of sales records or the Division's authority to resort to indirect audit methodologies in this case. As to the audit method employed by the Division, the extrapolation of the results of a one-day observation test over a multi-year period to determine taxable sales has been consistently sustained (*see, Matter of Del's Mini Deli, Inc. v. Commissioner of Taxation and Finance*, 205 AD2d 989, 613 NYS2d 967; *Matter of Sarantopoulos v. Tax Appeals Tribunal*, 186 AD2d 878, 589 NYS2d 102; *Matter of Marte*, Tax Appeals Tribunal, August 5, 2004). Hence the only issue is whether petitioners have established that the amount of tax assessed as a result of the application of the audit method employed herein was erroneous.

C. In contesting the audit results, petitioners point to no flaws in the specific observation methodology, but rather to the “final numbers.” This assertion is premised on the fact that the Division did not specifically audit the corporation’s gross sales (*see*, Findings of Fact “16”). According to petitioners, then, the Division accepted the corporation’s reported gross sales and thus for two of the quarters in issue the Division has illogically determined that taxable sales exceeded gross sales (*see*, Finding of Fact “19”). For other quarters, the taxable percentage of audited taxable sales to reported gross sales ranges widely (*id.*). Petitioners assert that such results make “no numerical sense” and that therefore the notices of determination should be rescinded.

Petitioners’ position is without merit. The record clearly shows that the Division did not accept the corporation’s gross sales as reported on its sales tax returns. Accordingly, the relationship or correlation or lack thereof between audited taxable sales and reported gross sales is irrelevant and has no bearing on the validity of the audit or the audit results.

The Division determined the corporation’s sales tax liability using an observation test that observed and recorded taxable sales and extrapolated the test results over the audit period to reach audited taxable sales. Given this audit method, it was not necessary to observe nontaxable sales or to estimate gross sales since the amount of nontaxable or gross sales would have no impact on the corporation’s sales tax liability. Thus, that the audit method did not include an estimate of gross sales cannot reasonably be construed as an acceptance of reported gross sales.

Petitioner's contention is also logically flawed. For sales tax purposes, gross sales equal taxable sales plus nontaxable sales. Thus, generally, an increase in taxable sales necessarily results in an increase in gross sales.<sup>2</sup>

That the Division did not accept the corporation's gross sales is also shown by its estimate of gross sales in the audit report. Such estimate, based on the corporation's gross receipts as reported on its 1998 and 1999 Federal income tax returns, totaled \$2,728,792.00. Gross sales as reported on the corporation's sales tax returns totaled \$1,742,038.00.

Finally, as to the validity of reported gross sales, it is noted that the corporation did not report gross sales for four of the twelve sales tax quarters in the audit period. It is further noted that petitioners offered no source documentation of the corporation's actual gross sales.

D. A review of the evidence in this matter reveals an error in the audit calculations. The Division determined on audit that the corporation's stores had reduced sales on weekends (*see*, Finding of Fact "9"). A weekend is, of course, a two-day period.<sup>3</sup> The Division appears to have allowed, however, only one reduced sales day per weekend. Specifically, the Division allowed 156 reduced sales weekend days for Austin Boulevard over a three-year audit period. There are 312 weekend days in a three-year period. For Lawson Boulevard, the Division allowed 88 reduced sales weekend days over the 22-month period spanning May 1, 1999 through February 28, 2001. There are 95 weekends and 190 weekend days in this period. Accordingly, the Division is directed to modify the subject assessments by allowing 312 weekend days for the

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<sup>2</sup> One caveat to this formulation: An increase in taxable sales will not increase gross sales where such increase results from a disallowance of nontaxable sales. However, such is not the case in the instant matter.

<sup>3</sup> The audit report, audit workpapers and the auditor's testimony refer to "weekends" without further definition or qualification.

Austin Boulevard store and 190 weekend days for the Lawson Boulevard store in its calculation of additional taxable sales.

E. The petitions of Got-A-Lot-A-Dough, Inc. and Catherine Kuncman are granted to the extent indicated in Conclusion of Law “D” and are in all other respects denied. The Division of Taxation is directed to modify the notices of determination dated May 15, 2003 and June 6, 2003 in accordance with Conclusion of Law “D” and as modified, such notices are sustained.

DATED: Troy, New York  
February 2, 2006

/s/ Timothy J. Alston  
ADMINISTRATIVE LAW JUDGE